

**STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA**

REPORT ON LIMITED-SCOPE EXAMINATION

As of

DECEMBER 31, 2005

Of the

KNIGHTS OF PETER CLAVER INSURANCE COMPANY, INC.

NEW ORLEANS, LOUISIANA

PARTICIPATION:

**SOUTHEASTERN ZONE
ALABAMA**

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EXHIBIT J
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION

State of Alabama,
County of Montgomery,

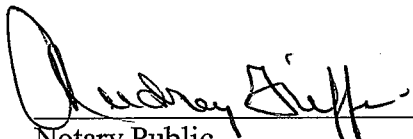
Jack M. Brown, CFE, being duly sworn, states as follows:

1. I have authority to represent the State of Alabama in the examination of Knights of Peter Claver Insurance Company, Inc.
2. The Alabama Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report, and the examination of Knights of Peter Claver Insurance Company, Inc. was performed in a manner consistent with the standards and procedures required by the National Association of Insurance Commissioners and the State of Alabama.

The affiant says nothing further.


Examiner's Signature

Subscribed and sworn before me by _____ on this 5th day of July,
2007.


Notary Public
My commission expires 11/2/09.

EXAMINATION AFFIDAVIT

STATE OF ALABAMA

COUNTY OF MONTGOMERY

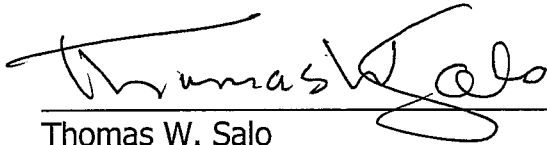
Thomas W. Salo being first duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That a limited-scope examination was made of the affairs and financial condition of Knights of Peter Claver Insurance Company for the period of January 1, 2004 through December 31, 2005.

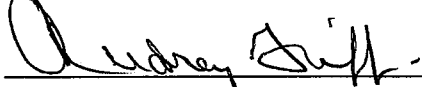
That the following 36 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

And, that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.



Thomas W. Salo
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this May 25, 2007,



(Signature of Notary Public)



Printed name

Notary Public

in and for the State of Alabama

My commission expires 11/2/09



BOB RILEY
GOVERNOR

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May 25, 2007

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Washington, DC 20002

Walter A. Bell, Commissioner
Alabama Dept. of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Dear Commissioners:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a limited-scope examination has been made of the affairs and financial condition of the:

Knights of Peter Claver, Inc.
New Orleans. Louisiana

at its home office located at 1825 Orleans Avenue, New Orleans, Louisiana as of December 31, 2005. The report of examination is submitted herewith. Where the description "Order" appears herein without qualification, it will be understood to indicate Knights of Peter Claver, Inc.

IDENTIFICATION OF THE COMPANY

The company being examined is Knights of Peter Claver Insurance Company, a non-profit fraternal benefit society with a lodge system and a representative form of government. The Order's home office is in New Orleans, Louisiana. However, because of severe damage to its home office in New Orleans, the Order has temporarily relocated to Montgomery, Alabama and it is here that the majority of the examination work was performed. The Company's main line of business is life insurance. The date of the last full-scope combined financial and market conduct examination covered the three-year period ended December 31, 2003, and was conducted by examiners from the Alabama Department of Insurance.

As previously mentioned, the Order suffered major damage as a result of Hurricane Katrina and the subsequent flooding that resulted from this major wind event. The Order's home office had several feet of water in it for approximately two weeks. Not only did the Order lose the use of its home office, it also lost its accountant/bookkeeper.

Hurricane Katrina and its flood waters not only closed down the home office of the Order, it also closed down the offices of the Order's long-standing opining CPA firm, Bruno & Tervalon. The Order was very dependent on this firm for their accounting and the Order had great difficulty in obtaining another CPA firm. It took an inordinate amount of time to contract another firm, and as a result, the Order was seriously delinquent in filing its 2005 Annual Statement. The Order has contracted with a new CPA firm, Banks, Finley, White & Company, of Birmingham, Alabama, to perform their annual independent audit and to prepare their quarterly and annual financial statements. The 2005 Annual Statement was finally received on or about November 17, 2006, approximately eight months after the normal deadline. The limited-scope examination was, in large part, triggered by the fact that the Order did not issue its 2005 Annual Statement or its 2005 Audited Financial Statements within their timeframes.

On or about September 21, 2006, the Order was placed under Consent Order of Supervision by the Alabama Department of Insurance. The Order was placed under supervision because they had not submitted their December 31, 2005 Annual Statement by March 1, 2006 in accordance with the time frame prescribed by ALA CODE §27-34-36.

The Order was prohibited from engaging in the following transactions without the express written approval of the Commissioner of Insurance or his duly authorized Supervisor:

- a) Disposing of, conveying or encumbering any of the assets of Knights or its business in force;
- b) Withdrawing any monies from Knights' bank or checking accounts;
- c) Lending any of Knights' funds;
- d) Investing any of Knights' fields;
- e) Transferring any of Knights' properties;
- f) Incurring any debt, obligation or liability on behalf of Knights;
- g) Entering into any new reinsurance contract or treaty on behalf of Knights;
- h) Issuing to the public any automobile warranty policies backed by Knights;
- i) Destroying any records including hard copy or software.

On or about January 25, 2007, the Order was issued a Show Cause Order because:

- The Order has not followed the NAIC Annual Statement instructions prescribed by the NAIC Accounting Practices and Procedures Manual as required by Department Regulation 482-1-097 nor has it filed other financial statements correctly. The statements beginning with December 31, 2005 and going through the September 30, 2006 quarterly statement are full of errors and inconsistencies.
- The Order has not fully cooperated with the Supervisor of the Alabama Department of Insurance (ALDOI) during its supervision.
- The Order's actuarial opinion and audited financial statements are full of errors and inconsistencies. Both appear to have little or no real supportive documentation.
- The Order, even though it is under the Supervision of ALDOI, has failed to respond to ALDOI's inquiries regarding errors found in its financial statements.
- The Order has not demonstrated any progress in hiring staff members with experience in statutory accounting.

DISCLOSURE

This report is a limited-scope examination, and is not intended to communicate all matters of importance for an understanding of the Company's financial condition.

SCOPE OF THE EXAMINATION

This limited-scope examination reported herein covers the period from January 1, 2004 through December 31, 2005, and has been conducted by examiners representing the State of Alabama Department of Insurance. Events subsequent

to December 31, 2005, have been reviewed, and are reported herein, as deemed appropriate.

The limited-scope examination has been conducted in accordance with statutory requirements of the *Alabama Insurance Code* and regulations and bulletins of the Alabama Department of Insurance; in accordance with the applicable guidelines and procedures of the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

Certain required elements relating to the areas of examination will be included in this report. However, where no exceptions were noted in particular areas, details of the various tests conducted are not included. If exceptions were identified as part of this examination, the details of the exceptions, the related tests, and recommendations are included in the appropriate sections of this Report of Examination.

Concerns that will be addressed in this limited scope examination are, but not limited to the following:

Adequacy of loss reserves

Loss reserves will be examined and tested by the actuary representing the Alabama Department of Insurance to determine their sufficiency.

Refurbishing of home office

The Order's home office was seriously damaged by the flood waters of Katrina. The renovation of the home office will be examined.

Records/files damaged by Hurricane Katrina's flood waters

Numerous records and files were put into storage after the flood waters receded. The legibility of these documents will be examined.

Net income increase

Hurricane Katrina hit New Orleans August 29, 2005 and disrupted the Order's normal routine of business. However, the Order's net income rose from (\$38,214) to \$198,847. This will be examined.

Supervision

The Order was placed under formal supervision during the examination. This topic will be discussed further under the "Subsequent Events" section of this examination report.

ORGANIZATION AND HISTORY

The Order was incorporated as a non-profit fraternal benefit society on November 7, 1909, in Mobile, Alabama, under the laws of the State of Alabama as "Knights of Peter Claver, Inc."

The objectives or purpose of the incorporation, as set forth in the Certificate of Incorporation, are as follows:

- The rendering of pecuniary aid to the members of the Knights of Peter Claver and beneficiaries of the members.
- The rendering of mutual aid and assistance to the sick and disabled members of the Knights of Peter Claver.
- The promotion of such social and intellectual intercourse among its members as shall be desirable and proper and by such lawful means as may seem best.
- The location and establishment of subordinate councils or other branches or divisions thereof, composed of members of said corporation, in any town or city of this state, or any state of the United States, or any foreign country, and such councils, branches or divisions so established shall be governed and managed by such laws, by-laws, rules and regulations as said corporation shall determine, and said corporation may enforce such laws, by-laws, rules and regulations against any subordinate council, branch or division by action at law in any court in this state or any state of the United States, or any court in any foreign country and all subordinate councils or other branches therefore established by said corporation shall be governed by such laws, by-laws, rules and regulations as are now in force, or which may hereafter be adopted by said corporation by suit at law in this state or any state of the United States, or any court in any foreign country.
- The establishment, accumulation and management of a reserve or other fund in such manner and such amount as it may determine for the purpose of more effectually rendering aid and assistance to its members.

There are three classes of membership in the Order:

- 1) Insured members-entitled to all benefits of the Order.
- 2) Associate members- entitled to all benefits of the Order with the exception of insurance
- 3) Honorary members-consists of Priests, who may enjoy such membership without cost to themselves, shall not be assessed nor shall they receive insurance benefits unless they elect to become insured members by meeting all the requirements of such members.

FINANCIAL GROWTH OF THE COMPANY

The following schedule presents financial data, which reflects the growth of the Company for the years indicated:

<u>Year</u>	<u>Net Written Premiums</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
2004	\$1,256,170	\$3,559,321	\$1,622,733	\$1,936,588
2005	\$1,208,882	\$3,758,771*	\$1,582,945	\$2,175,826*

Data for the years 2004 and 2005 are per the Company's annual statements. Items indicated with * are per examination.

MARKET CONDUCT ACTIVITIES

Territory and Plan of Operation

The review of Schedule T of the 2005 Annual Statement indicated that the Order was licensed to conduct business in nine states/territories: Alabama, District of Columbia, Louisiana, Maryland, Nebraska, Oklahoma, Pennsylvania, Texas, and Virginia. The Executive Director did not have copies of the certificates of authority for these nine states available at the temporary Montgomery office, and did not know of their existence or their whereabouts at the home office in New Orleans, so he developed a generic request and mailed this request to the nine states as reported on Schedule T of the December 31, 2005 annual statement. All nine of the states responded and mailed copies of the certificates of authority back to the Order.

The Executive Director did not understand the intricacies of Schedule T and did not realize that the Order was not duly licensed in twenty-four other states. After

he realized that there were numerous certificates of authority still required, he contacted a company which purported to be able to obtain these necessary certificates of authority. Per the Executive Director, the only information this company requested from the Order was that they furnish the names of the board of directors and officers, along with their respective birth dates and social security numbers. This consultant company stated that with this information they could get the certificates of authority for the states where the Order was not properly licensed.

The normal process of an insurance company obtaining a new certificate of authority is much more complex than just getting names, birthdates and social security numbers of officers and directors. This was discussed with the Executive Director, and he ceased negotiations with this company.

The previous two examinations cited the Order for not being properly licensed in numerous states. The past Supreme Knight, Arthur McFarland, responded to a request during the last examination and stated that the Order had applied for licenses in sixteen states: California, Georgia, Maryland, Missouri, Oklahoma, Virginia, District of Columbia, Illinois, Michigan, New Jersey, Pennsylvania, Florida, Kentucky, Mississippi, Nebraska, and South Carolina.

Per Schedule T of the 2005 Annual Statement, the Order has written premiums in thirty-three states. To date, the Order was able to provide certificates of authority for only nine states as mentioned above. However, the Order continues to collect premiums in states where they were not duly licensed when the policies were originally written. Additionally, the Order is licensed in South Carolina but they did not provide a certificate from South Carolina nor did they report on Schedule T that South Carolina was licensed.

Prior to 1999, the Order issued insurance policies and collected premium payments from insured members in states in which the Order did not hold certificate of authority to engage in the business of insurance; and in 1999, the Order agreed with the Alabama Department of Insurance to cease writing policies in states where the Order did not hold certificates of authority but could collect premium payments on policies issued before the agreement date.

Membership in the Order is restricted to practicing Roman Catholics who, at the time of initiation or obligation, are eighteen and over for Knights and Ladies. For Junior Knights and Junior Daughters, the prospective member must be between the ages of seven and eighteen. The assessments and dues are collected by the financial secretary of the subordinate councils and courts and are reported monthly to the Order's home office.

EXAMINATION FINDINGS

Adequacy of Loss Reserves

The examiner requested the CPAs workpapers on the testing of reserves on numerous occasions and was promised that the workpapers were forthcoming. After several weeks of waiting and numerous unfulfilled promises, the examiner resorted to traveling to the CPAs office to retrieve the aforementioned workpapers. Upon arrival at the CPAs office, it was discovered that there were no CPA workpapers available to peruse and review that related to the testing of the opining actuary's reportings on reserves.

In response to the examiner's inquiries concerning why no audit procedures were performed on the opining actuary's work, and how it was determined that the reserves were fairly stated, the CPA audit manager responded that they depended entirely on the information provided by the opining actuary. The CPA audit manager stated that they reviewed the credentials and qualifications of the opining actuary, and found them satisfactory. As a result, the CPAs utilized his reported amounts in their entirety with no further testing.

The NAIC's Annual Statement Instructions state that:

"The insurer shall require the independent certified public accountant to subject the information included in the Supplemental Schedule of Assets and Liabilities...to the auditing procedures applied in the audit of the current statutory financial statements to determine whether the information is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole and agrees to the insurer's annual statement filed with the state insurance departments and the NAIC."

No in-force tests were performed to verify the accuracy of the underlying records, no information was obtained, and no conclusions were reached pertinent to the CPA's examination of the opining actuary's reserve calculations; consequently, the examiners could not ascertain how the CPAs determined the reserves were fairly stated in relation to the statutory financial statements as a whole.

Further, the opining actuary is required to incorporate into the actuarial opinion the date he was appointed by the Board of Directors as the valuation actuary. The actuarial opinion provided by the opining actuary did not indicate such date. The opining actuary must also perform asset adequacy analysis. No such asset adequacy analysis workpapers were provided by the opining actuary. The Analysis of Increase in Reserves During the Year was not completed.

Also, during the examination, the Order could not provide the necessary detail and the subsequent calculation to enable the financial examiner to agree the amounts to Exhibit 5 of the 2005 Annual Statement, to the Exhibit of Life Insurance and to the General Ledger. It should be noted that the reserves shown in the worksheet do not agree with the amounts shown in the annual statement. In addition, there were no worksheets from the opining actuary that showed the derivation of the special contingency reserve, the group insurance reserve, the immediate payment of claims reserve or the nondeduction of deferred fractional premiums reserve.

The Order should maintain its records in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Also, the opining actuary was unable to provide the methodology for calculating the incurred but not reported claim liability. The workpapers provided by the accounting firm did not provide enough detail to check the adequacy of the IBNR claim liability.

The reserve calculations for the examination period were certified by the Company's actuarial consultant, Harrison & Associates, College Park, Georgia.

Refurbishing of Home Office

The Order's home office suffered severe damage as a result of the flood waters associated with Hurricane Katrina. The hurricane caused the levees to fail in New Orleans and the Order's home office was under four to five feet of water for over two weeks. Even though the Order had physical damage insurance, this coverage did not pay because the damage was associated with flooding and not the wind event itself. However, the Order did have flood insurance and the Order received a total of \$398,254 for the damages as a result of the flooding. Rather than use this money to repair the home office, the Order elected to invest this money into commercial paper with the Whitney Bank which had a maturity of four months. After this matured, it was invested in a money market account with the Whitney Bank. The repairs to the home office were funded through normal cash flows.

The Order contracted the refurbishing of the home office with The Design Craft Company, Houston, Texas, for a contract price of \$273,960. The repairs were handled via twelve contract draws. After each segment of the repairs was

completed, the building was inspected by appointed members of the Board of Directors to determine that the specific repairs, were in fact, completed. If the inspection was satisfactory, the contractor was paid. The building was reopened for business on or about March 1, 2007.

During the construction phase it was noted that the Order had no insurance on the home office. In fact, the building was completed in February, 2007 and the Order did not apply for physical damage and liability insurance on this building until April 11, 2007.

Records/files damaged by Hurricane Katrina's flood waters

The flood waters from Hurricane Katrina reached about two to three feet in the home office of the Order and certain documents were under water for about two weeks. After the water receded, these documents were placed in storage units nearby. An accurate listing of these items is not available as these items still remain locked up and an inventory has not been completed.

With these items being underwater for two weeks and then put in storage for over a year and a half, the legibility and usefulness of these documents is highly questionable. If the Order had taken a more expedient approach with these documents, it is possible that many may have been retrieved and salvaged.

Net Income Increase

At December 31, 2004, the Order had net income of (\$38,214) and at December 31, 2005, the Order's net income was \$262,736. This change in net income was due in part by \$100,200 in flood insurance proceeds which were received by the Order in 2005. This amount represented a partial payment for the damages caused by the flood waters resulting from Hurricane Katrina. The examination found that the Order omitted (Federated Treasury security) amounting to \$96,289 from its 2005 cash balance. Per the examination, the amount of \$96,289 was included as write-in income.

Also, the Order had \$273,146 in Grants and Contracts that was included as Write-in Income during 2005.

Supervision

On or about September 6, 2006, the Order was placed under a Consent Order of Supervision by the Alabama Department of Insurance. This is explained in further detail in the "Subsequent Events section" – page 25 of this examination report.

Detailed discussions and additional commentary on the above matters may be

found in the **COMMENTS AND RECOMMENDATIONS** section of this limited-scope examination report, under the various captions to which they relate.

MANAGEMENT AND CONTROL

The supreme legislative body of the Order is the National Council. All executive authority of the National Council is vested between conventions in a Board of Directors, which meet immediately before and after the annual national conventions. The members of the Board of Directors of the National Convention at December 31, 2005 were:

<u>Director</u>	<u>Title</u>
Arthur McFarland	Supreme Knight
Emmet C. Orr	Deputy Supreme Knight
Michael Taylor	National Secretary
Louis Hawkins, Jr.	National Treasurer
Dr. Robert Miller	Director/Trustee
A. Jackie Elly	Director/Trustee
Howard Crawford	Director/Trustee
Garry Bostick	Director/Trustee
Gerald W. Joseph	Director/Trustee
James A. Coleman	Director/Trustee
Leonard V. Stiell	Director/Trustee
Roosevelt Stevenson	Director/Trustee
Vincent Wilkins, Jr.	National Advocate
Mervin Hughes	Director/Trustee

FIDELITY BOND AND OTHER INSURANCE

The Order could not provide a copy of a Fidelity Bond so the examiners were not able to determine that the Order met the minimum requirements for fidelity coverage, as defined by NAIC guidelines.

However, the Order maintained:

Commercial General Liability Insurance

Commercial Property Insurance

Commercial Excess Liability Insurance

Flood Insurance

The Order's physical damage insurance did not apply to damages received from Hurricane Katrina. The damages from Hurricane Katrina resulted from the associated flood waters and the Order received a material amount in insurance proceeds from their flood insurance claim. However, the Order could not provide the evidence of the flood insurance coverage and had to retrieve the evidence from their insurance provider.

ACCOUNTS AND RECORDS

Accounting System

During the examination, it was noted that the Company's principal accounting records were maintained primarily on electronic data processing equipment. However, there were certain detail and subsidiary records that were kept in a manual format.

For the year 2004, the Order was audited by its opining certified public accounting (CPA) firm from New Orleans, Louisiana. It was noted that this accounting firm also conducted all of the Order's audits for 1998 through 2002, which was the five-year period covered by the previous full-scope examination. Moreover, the previous examination report revealed that this accounting firm has performed the Order's annual audits for the past twenty years.

After Hurricane Katrina, business with the Order and with its opining CPAs became disrupted. The Order's home office was severely damaged, and they relocated to a temporary office in Montgomery, Alabama. During this interim period, the Board of Directors of the Order sought another accounting firm to perform its annual independent audit as well as prepare its annual statement as they determined that the accounting services of its existing CPAs had gotten too expensive. The Order contracted with a CPA firm in Birmingham, Alabama to complete its quarterly and annual statements as the Order had no internal accountant/bookkeeper. These opining CPAs also performed the 2005 financial audit.

They also prepared the quarterly statements for 2006 as well as the 2006 annual

statement and the 2006 financial audit.

Accounting Records

On or about August 29, 2005, the Order's business routine was drastically interrupted by the flood waters in New Orleans resulting from the wrath of Hurricane Katrina. The home office of the Order was under several feet of water for over two weeks and, as a result, numerous files and documents were immersed under water. After the water receded, these files and documents were hurriedly put into storage and are still in these portable storage facilities. The content of the stored items and the damage to them can not be determined because they have not been inventoried. After being locked up in a portable storage unit for over eighteen months, the likelihood of these documents being retrievable and legible is very minimal.

After the hurricane, the Order temporarily relocated its home office in Montgomery, Alabama and resumed operations. However, the Order became seriously delinquent in the issuance of its 2005 Annual Statement which was due March 1, 2005.

On July 25, 2006, the first version of the 2005 Annual Statement was received by the Alabama Department of Insurance (ALDOI). On October 25, 2006, the second version of the 2005 Annual Statement was received and on February 5, 2007 a third version of the 2005 Annual Statement was received by ALDOI.

In all three versions of the annual statements there were numerous omissions, errors and inconsistencies. To aid in the examination process, the examiners, on numerous occasions, asked the CPAs to provide a listing of the amendments that were made to the 2005 Annual Statements. A reply to this request has never been received.

In the October version of the 2005 annual statement, the CPAs inserted a fictitious amount so that the statement would balance. The calculated amount of unassigned funds was \$2,135,435 while the "inserted" amount was \$2,125,246.

In the July version of the 2005 annual statement, a Federated Treasuries security valued at \$96,289 was properly listed as a short-term investment on Schedule DA. However, it was not included in the Cash balance on the Assets page. In this same annual statement, a common stock (Standard and Poors Dep Receipt) was not listed on Schedule D Part 2, but its value of \$103,966 was nonadmitted from the annual statement. This particular stock is in fact, valued by the SVO and should be an admitted asset.

In the February 5, 2007 version of the 2005 Annual Statement, the Standard and Poors stock is properly reported on Schedule D Part 2 and its value of \$103,966 has been nonadmitted. In this same annual statement, the Federated Treasury for \$96,289 is not reported anywhere and the Whitney Bank confirmation reports this as a security owned by the Order.

During the examination the examiners noted that the Order had two accounts with Merrill Lynch. However, the examiners could not locate evidence of these Merrill Lynch accounts and their respective balances totaling \$26,002 in the 2005 General Ledger or in the 2005 Annual Statement.

The absence of the Merrill Lynch accounts from the 2005 Annual Statement and the general ledger was discussed with the CPA's engagement partner, on April 4, 2007 and he located a summary sheet from Merrill Lynch in his workpaper file. This summary sheet indicated that the Order had \$12,897.66 on deposit with Merrill Lynch at December 31, 2005. However, he had no record of the other account in the amount of \$13,209.12 and he stated that even though there was evidence of an account relationship with Merrill Lynch, he did not pursue this issue further as this was not reported in the 2005 general ledger.

On or about April 11, 2007, a telephonic conversation was held between the examiner and the IT consultant/accountant for the Order, concerning the fact that the Merrill Lynch accounts did not appear on the Order's 2005 general ledger. She consulted her files and noted the absence of the two Merrill Lynch accounts. Also she acknowledged that there was a methodology error within her software program, and she was going to correct this and that, in the future, these accounts would be reported on the general ledger.

However, the above amounts were being held by Merrill Lynch without an approved custodial agreement. A custodian is defined by ALA. ADMIN. CODE 482-1-077-.04 (2003) which states, that a custodian is, in part..."A national, bank, state bank or trust company that shall at all times during which it acts as a custodian...and that is regulated by either state banking laws or is a member of the Federal Reserve System." Since Merrill Lynch is not a bank or a trust company, an approved custodial agreement could not be obtained. As mentioned previously, these Merrill Lynch accounts and their respective balances were not listed on the Order's general ledger and 2005 Annual Statement. If the Merrill Lynch balances were reported in the 2005 Annual Statement, their respective balances would be nonadmitted as they are being housed in a financial institution without a custodial agreement approved by the Commissioner of the Alabama Department of Insurance.

CPA Review of Reserves

The examiner requested the CPAs workpapers on the testing of reserves on numerous occasions and was promised that the workpapers were forthcoming.

Finally, the examiner resorted to traveling to the CPAs office to retrieve the aforementioned workpapers. Upon arrival at the CPAs office, it was discovered that there were no CPA workpapers available to peruse and review.

In response to the examiner's inquiries concerning why no audit procedures were performed on the opining actuary's work, and how was it determined that the reserves were fairly stated, the CPA audit manager responded that they depended entirely on the information provided by the actuary. The CPA audit manager stated that they reviewed the credentials and qualifications of the actuary, and found them satisfactory. As a result, the CPAs utilized his workpapers and reported amounts with no further testing.

The NAIC's Annual Statement Instructions state that:

"The insurer shall require the independent certified public accountant to subject the information included in the Supplemental Schedule of Assets and Liabilities...to the auditing procedures applied in the audit of the current statutory financial statements to determine whether the information is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole and agrees to the insurer's annual statement filed with the state insurance departments and the NAIC."

No tests were performed, no information was obtained, and no conclusions were reached pertinent to the CPA's examination of the opining actuary's reserve calculations; consequently, the examiners could not ascertain how the CPAs determined the reserves were fairly stated in relation to the statutory financial statements as a whole.

During the examination, numerous errors, inconsistencies and omissions were noted in the 2005 quarterly and year-end 2005 Annual Statements. The adjustments, per the examination, are disclosed in the Notes to Financial Statements section of this Examination Report.

Numerous hard-copy policy/application files are purportedly locked up in temporary storage units (commonly called P.O.D.S.) in New Orleans. These files were hurriedly placed in these storage facilities shortly after the flood waters caused by Hurricane Katrina receded. As there is no index or categorization of the files that were placed in storage, the Order can not, with certainty, disclose the exact contents of this storage unit. As of April 25, 2007, the storage unit remains locked and its exact contents are unknown. Further, the usefulness and legibility of these files are highly questionable as they were exposed to the flood waters for over two weeks. Even though the files were not available for review, it is highly doubtful that these files will be of any use as the Order waited too long for any restoration/recovery process to be effected.

Detailed discussions and additional commentary on the above matters may be found in the **COMMENTS AND RECOMMENDATIONS** section of this limited-scope examination report, under the various captions to which they relate.

FINANCIAL STATEMENTS

EXAMINER'S NOTE: SINCE THIS WAS A LIMITED-SCOPE EXAMINATION, CERTAIN AREAS OF THE ORDER'S FINANCIAL CONDITION WERE **NOT** REVIEWED. EMPHASIS WAS FOCUSED ON BONDS, CASH, REAL ESTATE AND AGGREGATE RESERVES FOR LIFE CERTIFICATES AND CONTRACTS.

EXCEPTIONS WILL BE DULY NOTED WITHIN THE FOLLOWING FINANCIAL STATEMENTS. OTHERWISE, AMOUNTS REPORTED IN THE ORDER'S DECEMBER 31, 2005 ANNUAL STATEMENT WILL BE UTILIZED.

Financial statements included in this report, which reflect the operations of the Order for the years under this limited-scope examination and its financial condition at December 31, 2005, consist of the following:

	<u>Page</u>
Statement of Assets, Liabilities, Surplus, and Other Funds	17
Comparative Summary of Operations	18
Reconciliation of Capital and Surplus	19

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL
STATEMENTS ARE AN INTEGRAL PART THEREOF.**

STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the year ended December 31, 2005

	<u>ASSETS</u>		
	<u>Ledger Assets</u>	<u>Non-Admitted Assets</u>	<u>Admitted Assets</u>
Bonds (NOTE 1)	\$ 2,457,910		\$ 2,457,910
Preferred stock (NOTE 2)	316,276		\$ 316,276
Common stock (NOTE 3)	385,811		\$ 385,811
Mortgage loans-first liens	39,554	28,479	\$ 11,075
Real estate-property occupied by the Order (NOTE 4)	264,587	111,856	\$ 152,731
Real estate-held for production of income	13,341	10,796	\$ 2,545
Cash (NOTE 5)	366,101	17,214	\$ 348,887
Investment income due and accrued	33,934		\$ 33,934
Electronic data processing equipment & software	2,406		\$ 2,406
Aggregate write-in for other than invested assets	71,171	23,975	\$ 47,196
Total Assets	3,951,091	192,320	\$ 3,758,771

LIABILITIES SURPLUS AND OTHER FUNDS

Liabilities

Aggregate Reserve for Life Contracts (NOTE 6)	\$ 1,372,301
Contract Claims-Life	\$ 101,987
Interest Maintenance Reserve	\$ (3,018)
General Expenses Due and Accrued	\$ 13,161
Amounts withheld by society as agent	\$ 39,791
Asset Valuation Reserve	\$ 56,620
Aggregate Write-Ins for Liabilities	\$ 2,103
	\$ 1,582,945

Surplus and Other Funds

Unassigned funds (NOTE 7)	\$ 2,175,826
Total Liabilities and Unassigned Funds	\$ 3,758,771

COMPARATIVE SUMMARY OF OPERATIONS

For the years ended

2005 2004

Income:

Premium considerations	\$ 1,208,882	\$ 1,256,170
Net investment income	81,529	163,052
Amortization of Interest Maintenance Reserve	(3,017)	(3,017)
Agg. write-ins for misc. income (NOTE 5)	733,891	342,223
Total income	<u>\$ 2,021,285</u>	<u>\$ 1,758,428</u>

Deductions:

Death benefits	\$ 415,668	\$ 492,510
Increase in aggregate reserve for life contracts	63,083	\$ (29,662)
General ins.exp.& frat. exp. (NOTE 5)	1,540,729	1,332,844
Total Deductions	<u>\$ 2,019,480</u>	<u>\$ 1,795,692</u>

Net gain from operations	1,805	(37,264)
Net realized capital gain (loss)	69,899	(950)
Net income	<u>\$ 71,704</u>	<u>(38,214)</u>

RECONCILIATION OF CAPITAL AND SURPLUS

For the years ended December 31,		
	<u>2005</u>	<u>2004</u>
Surplus, January 1,	\$ 1,936,588	\$ 2,089,202
Net income	71,704	(38,214)
Change in net unrealized capital gain or (losses)	32,743	34,032
Change in non-admitted assets	96,093	(122,273)
Change in Asset Valuation Reserve	38,698	(26,159)
Change in surplus during year	<u>239,238</u>	<u>(152,614)</u>
Surplus, December 31, (NOTE 7)	\$ 2,175,826	\$ 1,936,588

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Bonds

\$2,457,910

The captioned amount is \$10,401 more than the \$2,447,509 reported by the Order in its 2005 Annual Statement. The Order included a twenty-four month certificate of deposit as a Cash Equivalent in its Annual Statement. This particular certificate of deposit has a maturity term of two years. According to SSAP No. 26, paragraph 2, of the Accounting Practices and Procedures Manual, which states in part..."certificates of deposit with a maturity date in excess of one year... should be classified as bonds."

Note 2 – Preferred stocks

\$316,276

The captioned amount is the same as reported by the Order in its 2005 Annual Statement. This amount agreed to the confirmation received from the Order's custodial bank.

Note 3 - Common stocks

\$385,811

The captioned amount is \$103,966 more than the amount reported by the Order in its 2005 Annual Statement. The Order reported the security, Standard & Poors Dep Receipt, Cusip #78462F103, valued at \$103,966, on Schedule D - Part 2 – Section 2. Even though the aforementioned security was properly reported, the Order nonadmitted the \$103,966 from the 2005 Annual Statement. The revised amount per the examination, agrees to the confirmation received from the Order's custodian, Whitney Bank.

Note 4 - Properties occupied by the Order

\$152,731

The captioned amount is the same as reported in the Order's 2005 Annual Statement. However, it was noted that the Order did not report in its 2005 Annual Statement, that its home office was damaged severely by the flood waters resulting from Hurricane Katrina which occurred on or about August 29, 2005. The values reported for Properties occupied by the Order in the 2005 Annual Statement did not indicate that any damage had occurred whatsoever.

To complicate the issue, the last appraisal on the home office realty was in 1996. ALA. CODE §27-37-7 (1975) states, in part... real property held by an insurer shall not be valued at an amount in excess of fair value as determined by a recent appraisal...less than three years old.

The lack of a current market appraisal was discussed in the exit conference of the last full-scope examination and the Order was supposed to have a current market appraisal on the property available in 2006.

Even though no estimate of the damages or the cost to rebuild were available, in accordance with SFAS 144, of the Financial Accounting Standards Board, the Order should have disclosed in its 2005 Annual Statement that its home office and its accompanying valuation were severely impaired by the flood waters of Hurricane Katrina. Within this disclosure, the accounting methodology associated with the impairment should have been reported. Also, SSAP No. 5 paragraph 14, of the Accounting Practices and Procedures Manual states, in part..."disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate can not be made."

With the lack of a current appraisal coupled with the damages from the flood waters, the examiners are not able to attest to the value of the home office property as of December 31, 2005.

<u>Note 5 - Cash</u>	<u>\$348,887</u>
<u>Cash Equivalent</u>	<u>\$ - 0 -</u>

The captioned amounts are \$103,677 less than and \$182,752 less than the amounts reported in the 2005 Annual Statement, respectively.

The Order's bond confirmation from its custodial bank reported a Federated Treasury in the amount of \$96,289. This amount was not reported by the Order in its 2005 Annual Statement. This security should have been reported as a short-term investment in Schedule DA – Part 1 as it matured in one year. The examiner verified inclusion of this Federated Treasury in Section 8 (exempt mutual funds) of the NAIC VOS. The examiners recorded the \$96,289 in the statutory annual statement by debiting cash by \$96,289 and crediting other miscellaneous income by \$96,289.

The Order reported a Federated Treasury in the amount of \$172,351 for which no supporting factual documentation could be provided by the Order's CPAs. Since the Order could not provide any evidence of the asset, the Order was not in compliance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

The asset has been taken off the books of the Order by reducing Cash Equivalents by \$172,351 (crediting) and debiting the miscellaneous income by \$172,351.

The examiners had difficulty in verifying the balance in the Order's checking account with Liberty Bank as the listing of outstanding checks for year-end 2005 could not be provided. As a result, the amount of \$17,214 will be nonadmitted.

The Order misclassified a \$10,401 Certificate of Deposit as a Cash Equivalent. According to SSAP No. 2 paragraph 3 of the Accounting Practices and Procedures Manual which states, in part...cash equivalents are investments with maturities of three months or less. This security had a maturity of twenty-four months. [see Note 1 as this amount should be reported as a Bond since its maturity is in excess of one year].

The Cash reconciliation per examination follows:

Cash admitted balance per 2005 Annual Statement	\$452,564
Whitney Bank [Federated Treasuries]	96,289
Cash Equivalents:	
Federated Treasuries	(172,351)
Certificate of Deposit (reclassified)	<u>(10,401)</u>
Total ledger assets	\$366,101
Whitney Bank (nonadmitted)	<u>(17,214)</u>
Net Admitted	\$348,887

<u>Note 6 – Aggregate reserves for life certificates</u>	<u>\$1,372,301</u>
<u>and contracts</u>	
<u>Contract claims</u>	<u>\$101,987</u>

The captioned amounts for Aggregate reserves for life certificates and contracts and Contracts claims agreed to the amounts reported in the Order's December 31, 2005 Annual Statement.

The Order could not provide the necessary detail and the subsequent calculation to enable the financial examiner to agree the amounts to Exhibit 5 of the 2005 Annual Statement and to the General Ledger. Detail was provided but the totals did not agree with the amounts reported in Exhibit 5 or to the Exhibit of Life Insurance of the 2005 Annual Statement. Further, no detail could be provided for the Contingency Reserve in the amount of \$963,083.

There have been no changes in the valuation basis in the reserve computation since the last examination. However the reserves on the group certificates subject to the 50 year membership rider have not been calculated correctly and should be adjusted, but the examination actuary was not provided with sufficient detail so as to check those reserves.

In addition, there were no worksheets from the opining actuary that showed the derivation of the special contingency reserve, the group insurance reserve, the immediate payment of claims reserve or the nondeduction of deferred fractional premiums reserve.

The analysis of increase in reserves was not completed correctly. The disclosures state that tabular interest and tabular cost are not applicable to the Company. However, tabular interest and tabular cost are applicable and should be calculated correctly in the analysis of increase in reserves.

The opining actuary was unable to provide the methodology used to calculate the incurred but not reported claim liability. The workpapers provided to the examination actuary did not detail how the claim liability was established. The opining actuary stated that the auditor had established the claim liability, but the actuarial certification requires that the opining actuary certify to that liability.

<u>NOTE 7 - Unassigned Funds</u>	<u>\$2,175,825</u>
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The captioned amount is \$10,690 more than the \$2,164,135 reported by the Order in its 2005 Annual Statement. The \$2,164,135 amount reported by the Order included a Change in Nonadmitted Assets in the amount of (\$9,341). The review of the accounts and records indicated that the Order erroneously reported

the decrease in the Change in Nonadmitted Assets with a negative (\$9,341) instead of \$9,341. To correct the error, the examiners increased miscellaneous expenses by \$18,682.

Immediately following is a reconciliation of unassigned funds per this examination:

Unassigned funds balance per Company	\$2,165,135
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Examination increase/(decrease) to assets:

CHANGES IN ASSETS:

Bonds	\$10,401
Common stocks	\$103,966
Cash-	
Federated Treasury	\$96,289
Whitney Checking	(\$17,214)
Whitney CD	(\$10,401)
Federated Treasury	(\$172,351)
	<u>(\$103,677)</u>

TOTAL INCREASE TO ASSETS	\$10,690
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Examination (increase)/decrease to liabilities:

CHANGES TO LIABILITIES	- 0 -
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TOTAL (INCREASE) TO LIABILITIES	<u>- 0 -</u>
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Examination increase/(decrease) to Unassigned Funds	<u>\$10,690</u>
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Unassigned funds balance per examination	\$2,175,825
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CONTINGENT LIABILITIES AND PENDING LITIGATION

Examination of these items included the following: a review of the Company's statutory financial statement disclosures and obtaining letters of representation from management and the Order's legal counsel.

At the onset of the examination, the Order did not report any contingent liabilities or pending litigation that were deemed to have potential for material adverse action on its surplus. The Order's Supreme Knight, the National Secretary, and the National Treasurer executed the initial letter of representation on July 10, 2006 attesting to the non-existence of liabilities and contingencies.

The final letter of representation was delivered to the Order's home office in New Orleans on April 23, 2007. Per the Executive Director, the new Supreme Knight was reluctant to sign this document because numerous items referred to in the final letter of representation were associated with events that occurred prior to him taking office. Purportedly, he has sought legal guidance from the Order's National Advocate.

Details associated with the final letter of representation are further discussed in "Final Letter of Representation" at page 30.

The examination found that the Order has written premiums in twenty-five states where it is not duly licensed. This issue has been addressed in the two previous full-scope examinations. To date, the Order has not corrected the licensing problems that were cited.

Potential contingent liabilities could result from premiums being written in states where the Order is not licensed.

Details of these are discussed further in "Market Conduct" at page 6.

SUBSEQUENT EVENTS

Supervision

On or about September 6, 2006, the Order was placed under Consent Order of Supervision because they had not submitted their December 31, 2005 Annual Statement by March 1, 2006 in accordance with the time frame prescribed by ALA CODE. §27-34-36:

Annual statements - Requirements

(a) Report shall be filed and synopses of annual statements shall be published in accordance with the provisions of this section.

(b) Every society transacting business in this state shall annually, on or before March 1, unless for cause shown such time has been extended by

the commissioner, file with the commissioner a true statement of its financial condition, transactions and affairs for the preceding calendar year and pay a fee of \$10.00 for filing same. The statement shall be in general form and context as approved by the National Association of Insurance Commissioners for fraternal benefit societies and as supplemented by additional information required by the commissioner.

(c) A synopsis of its annual statement providing an explanation of the facts concerning the condition of the society thereby disclosed shall be printed and mailed to each benefit member of the society not later than June 1 of each year, or, in lieu thereof, such synopsis may be published in the society's official publication.

The Order did not have an accounting firm as management had contended that the accounting fees with their long-time opining accountants had gotten too expensive. They searched for several months to find a new accounting firm to perform their independent annual audit as well as publish their quarterly and annual statements. The Order contracted with a CPA firm located in Birmingham, Alabama, and the first 2005 Annual Statement was received by the Alabama Department of Insurance on July 25, 2006. Also, the first and second quarter of 2006 statements were received at this same time. Since July 25, 2006, two amended versions of the 2005 Annual Statement were received by the Department on November 22, 2006 and February 9, 2007 respectively. Review of these statements revealed numerous errors and/or omissions and inconsistencies. Also, during this time it was noted that the informal supervision was not productive as the Order was not complying with the covenants of the informal agreement between the Order and the Alabama Department of Insurance. On or about September 24, 2006, the Executive Director of the Order signed a Consent Order of Supervision whereby "the Knights of Peter Claver (Knights) and its officers, directors and employees, and all others who have knowledge of this Supervision Order are prohibited from engaging in the following transactions without the express written approval of the Commissioner of Insurance or his duly authorized Supervisor:

- Disposing of, conveying or encumbering any of the assets of Knights or its business in force
- Withdrawing any monies from Knights' bank or checking accounts
- Lending any of Knights' funds;
- Investing any of Knights' funds;
- Transferring any of Knights' properties;
- Incurring any debt, obligation or liability on behalf of Knights;

- Entering into any new reinsurance contract or treaty on behalf of Knights;
- Issuing to the public any automobile warranty policies backed by Knights;
- Destroying any records including hard copy or software.

The Order has failed to fully cooperate with the Supervisor for the Alabama Department of Insurance in that it has not provided any information relating to the investing of any of Knights' funds. Also, the Order did not provide the necessary documentation required for the Supervisor to approve all disbursements prior to being paid.

A Show Cause Order was issued to the Knights on January 25, 2007 because the actuarial opinion and audited financial statements submitted for 2005 from the Order's outside actuary and auditors were full of errors and inconsistencies. Both of these documents appeared to have little or no supporting documentation.

The Knights, even though it is under the Supervision of the Alabama Department of Insurance, has failed to respond to the Department's inquiries regarding the errors found in its financial statements. The Order has not demonstrated any progress in hiring staff members with knowledge and experience in statutory accounting.

"Inasmuch as Knights has not followed the NAIC Annual Statement instructions prescribed by the NAIC Accounting Practices & Procedures Manual as required by Department Regulation Chapter 482-1-097 nor has it filed its other financial statements correctly together with the other enumerated issues, it is hereby **ORDERED** that Knights **SHOW CAUSE** as to why the Department should not suspend its Certificate of Authority until such time as it has taken the necessary corrective actions to resolve these issues."

On February 13, 2007, the Alabama Department of Insurance received a response from the Executive Director of the Knights. He stated that the CPAs filed an amended 2005 Annual Statement as well as amended quarterly statements for 2006. However, review of these documents indicates that the errors and/or omissions continue. The Executive Director stated that the Order was fully cooperating with the Department's Supervisor as regards to the payment of the bills of the organization. The review of the communication of the electronic mail between the Supervisor and the Order indicates that this problem still exists. It appears they are paying bills prior to obtaining the approval of the Supervisor.

The Order provided a response as regards the documentation supporting the CPA firm's and the Actuary's calculations. Also provided was a CD containing detail relating to the Aggregate Reserves of the Order. However, there was no

supporting detail or methodology supporting the \$900,000 contingency reported on the actuary's worksheet.

The financial examiner questioned the Executive Director as to the status of the accountant that was to be hired from the pool of applicants that resulted from the job being listed on an employee search web-site. As of March 9, 2007 the accountant position had not been filled. Further, of the 32 applicants on the listing, none were versed in statutory accounting.

On or about April 9, 2007, the Order hired a new accountant purportedly versed in statutory accounting.

Home Office Appraisal

On or about April 16, 2007, a current market appraisal on the home office was received by the examiners. This appraisal lists the home office, by sales comparison approach, to be valued at \$580,000. The examiner reviewed this appraisal and noted that the appraisal was performed at the request of a lender. The financial examiner questioned the Executive Director of the Order as to whether or not they were going to leverage the home office for a loan, and he said no and that the appraiser had made an error

Also, there was an error in the appraiser's calculation. The appraiser stated, "The adjusted comparables range from \$44.82 PSF to \$82.92 PSF. It is the opinion of the appraiser that the subject value is closer to the middle of the value range. The appraiser estimated that the value of the subject property to be \$83.00 per square foot. When the \$83.00 per square foot estimate is applied to the 6,983 square feet of the subject, the estimated value of the subject property is \$579,850, rounded to \$580,000."

If the appraiser used the middle of the value range, the calculation would be \$64.00 per square foot. When the \$64.00 per square foot is applied to the 6,983 square feet of the subject property, the estimated value of the subject property is \$446,912, a material difference of \$133,088.

The Order's home office was refurbished and the new appraisal on this realty would serve as supportive detail of the new admitted value that needs to be established on this property.

After Hurricane Katrina, the physical damage insurance on the Order's home office was cancelled. As mentioned elsewhere, the Order did have flood insurance which did pay the Order's claim for damages caused by the flood waters resulting from Hurricane Katrina, but they could not provide evidence of this coverage.

However, during the reconstruction of the Order's home office there was no physical damage insurance on the home office in force. The Order completed the

refurbishing of the home office and on or about March 2007, the home office was open for business. The Executive Director provided copies of applications where the Order has sought property and liability coverage on the home office.

Corrective Action Plan

On March 14, 2007, the analyst at ALDOI wrote the Order a letter concerning the numerous errors and inconsistencies found in the 1st, 2nd and 3rd quarter financial statements. The letter stated, "If the deficiencies in the three quarterly statements are not corrected;, [sic] the Department will consider employing its own experts to reconstruct and file financial statements for Knights of Peter Claver. This is within our discretion under ALA. CODE §27-2-23(c)(1975)."

In response to this letter, a meeting was requested by the National Treasurer of the Order. On March 23, 2007, a meeting was held at ALDOI with the Order's National Treasurer, and at the meeting representing ALDOI was the examiner-in-charge; the Assistant Chief Examiner; the analyst; an Assistant Attorney General and the Chief Receiver. During the meeting, the examiner-in-charge and the analyst expressed their concerns relating to the erroneous financial statements and financial condition of the Order. It was discussed that the Order needed to hire an internal staff accountant who was versed in statutory accounting.

On March 26, 2007, the analyst wrote a letter to the Supreme Knight, and summarized the issues discussed in the March 23rd meeting which was held with the Order's National Treasurer. Also, this letter requested that the Order present a written corrective action plan for resolving the Order's financial problems. Further, the letter stated that it was essential that the Order hire a staff member with knowledge of statutory accounting and preparation of financial statements for insurance companies.

In addition, the corrective action plan "would need to address how the present financial statements are to be corrected, as well as maintained going forward. It would need to address your plans regarding an actuary and certified public accountant, as well as staff members that would be responsible for preparation of financial statements."

On April 9, 2007, the analyst for ALDOI sent a letter to the Order requesting additional information and/or documentation relating to the December 31, 2006 Annual Statement. Once again, it was mentioned that if the deficiencies were not corrected, ALDOI was going to consider hiring forensic accountants to reconstruct the Order's financials.

On April 10, 2007, the Supreme Knight requested an acceptable format with which to submit their corrective action plan.

On April 12, 2007, ALDOI sent a letter along with a template of a corrective action plan to the Supreme Knight. This letter also requested:

- a profile on the Order's newly hired internal accountant
- plans relating to the Order's certified public accountant and actuary
- long-term plans regarding insurance

On April 24, 2007, the Supreme Knight submitted a corrective action plan to ALDOI which had been approved by the Order's Executive Committee. This business plan addressed the issues relating to the erroneous financial statements; the Order's plan of action; the responsible party(ies) for performing the action; and the timeframe to complete the action.

According to the Order's Plan of Corrective Action, a new staff accountant was hired on April 9, 2007, and she is currently working with the opining certified public accountants to facilitate the corrections to the financial statements.

The Plan of Corrective Action is in its infancy. Its success and the solvency of the Order are yet to be determined.

Final Letter of Representation

On July 10, 2006, the former Supreme Knight, National Secretary and National Treasurer signed the initial letter of representation. In this document, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2005.

The final letter of representation was sent to the new Supreme Knight and was received at the Order's home office in New Orleans on April 23, 2007. The contents of this document were very similar to the final letter of representation associated with the prior full-scope examination as of December 31, 2003, that was signed by the former Supreme Knight, Executive Director and Treasurer on or about June 21, 2004. However, the new Supreme Knight was reluctant to sign this document stating that there were issues mentioned in the final letter of representation that occurred prior to him taking office.

A second, final letter of representation was sent on May 17, 2006 to the Order's home office in New Orleans. The contents of this document are identical as the letter that was previously received by the Order on April 23, 2007. As of May 25, 2007, the final letter of representation has not been returned to the Alabama Department of Insurance in accordance with ALA. CODE 482-1-118-.06 which states, "The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the

nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay."

The final letter of representation is an important, integral document to a financial examination and needs to be included as part of the examination process.

COMMENTS AND RECOMMENDATIONS

Territory and Plan of Operation – page 6

It is again recommended that the Order obtain licensing in all states where it has written business and is now collecting premiums. This has been recommended in the prior two examinations.

Fidelity Bond and other Insurance - page 11

It is recommended that the Order obtain a Fidelity Bond that meets the minimum requirements as set forth by NAIC guidelines.

It is recommended that the Order maintain its records and insurance policies in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Accounts and Records- page 12

It is recommended that the Order complete all necessary schedules and exhibits in its quarterly and annual financial statements in accordance with the NAIC Annual Statement Instructions.

It is recommended that the Order maintain its records in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its

principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the CPA firm engaged to perform the Order's annual financial audit demonstrate independence and not perform other accounting functions for the Company, including, but not limited to, the compilation of Quarterly and Annual Statements.

It is recommended that the Order maintain its funds in a national bank, state bank or trust company governed by a custodial agreement approved by the Commissioner of the Alabama Department of Insurance in accordance with ALA. ADMIN. CODE 482-1-077-.04 (2003) which states, that a custodian is, in part...

"A national, bank, state bank or trust company that shall at all times during which it acts as a custodian...and that it is regulated by either state banking laws or is a member of the Federal Reserve System."

CPA Review of Reserves – page 14

It is recommended that the Company require that its independent CPAs test the opening actuary's reserve calculations in accordance with guidelines established by the NAIC's Annual Statement Instructions in order to determine that the reserves are "fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole and agrees to the insurer's annual statement filed with the state insurance departments and the NAIC.

Aggregate Reserves for Life Certificates and Contracts-page 8 and NOTE 6 - page 23

It is recommended that the opening actuary incorporate into the actuarial opinion the date he was appointed by the Board of Directors as the valuation actuary.

It is also recommended that the opening actuary perform asset adequacy analysis and provide workpapers in sufficient detail such that the examination actuary can verify the appropriateness of the asset adequacy analysis.

It is further recommended that the Order's opening actuary and/or the Order provide the necessary workpapers and supporting detail necessary for the

financial examiner and the examination actuary for the Alabama Department of Insurance to be able to reconcile and agree the amounts reported in Exhibit 5-Aggregate Reserve for Life Contracts and the Exhibit of Life Insurance in accordance with ALA. CODE § 27-27-29(a)(1975).

It is recommended that the Order complete the Analysis of Increase in Reserves During the Year in accordance with the Annual Statement instructions.

Notes to Financial Statement- Bonds-Note 1 - page 20

It is recommended that the Order classify its twenty-four month certificate of deposit as a bond in accordance with SSAP No. 26, paragraph 2 of the Accounting Practices and Procedures Manual, which states in part, certificates of deposit with a maturity date in excess of one year should be classified as bonds.

Notes to Financial Statement –Common Stocks- Note 3 - page 20

It is recommended that the Order refrain from nonadmitting common stocks that are considered an admitted asset.

Notes to Financial Statement – Real Estate-Properties Occupied by the Order –Note 4 – page 20

It is recommended that since the home office was severely damaged, the Order adjust the value of this realty accordingly, and disclose within its notes to financial statements, the methodology utilized to effect such impairment in accordance with SSAP No. 5 paragraph 14, of the Accounting Practices and Procedures Manual which states, "...disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate can not be made."

It is further recommended that the Order readjust the value of the home office after the repairs to the property are completed and enhancements have been made.

It is recommended that the Order obtain and maintain a current real estate appraisal on its home office that is accurate and reflects the true value of the property in accordance with ALA. CODE §27-37-7 (1975) which states, in part,

"...real property held by an insurer shall not be valued at an amount in excess of fair value as determined by a recent appraisal...less than three years old."

Notes to Financial Statement-NOTE 5- Cash-page 21

It is recommended that the Order maintain accurate records of its cash accounts in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is also recommended that the Order reconcile its checking accounts on a timely, at least monthly, basis.

It is further recommended that the Order classify certificates of deposit with relation to their individual maturity. If the maturity exceeds one year, the certificate of deposit is classified as a bond.

Notes to Financial Statement-NOTE 6-Aggregate Reserves of Life Certificates-page 22

It is recommended that the Order maintain its records and reserves in accordance with ALA. CODE § 27-27-29(a)(1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Subsequent Events- page 25

It is recommended that the Order file its quarterly and annual statements within the timeframe as prescribed in ALA CODE. §27-34-36:

It is recommended that the Order abide by the covenants stipulated in the Consent Order of Supervision which was issued September 24, 2006

It is recommended that the Order readjust the value of its home office since this realty has just been refurbished.

It is recommended that the Order maintain an accurate real estate appraisal on its home office in accordance with ALA. CODE §27-37-7 (1975) which states, in part, "...real property held by an insurer shall not be valued at an amount in excess of fair value as determined by a recent appraisal...less than three years old."

It is recommended that the Order complete the final letter of representation in accordance with ALA. CODE 482-1-118-.06 which states, "The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay."

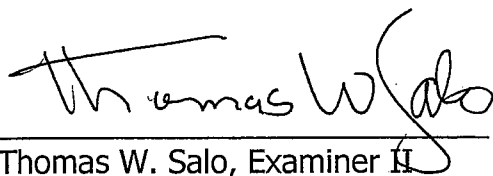
CONCLUSION

Acknowledgement is hereby made of the courteous cooperation extended by persons representing Knights of Peter Claver, Inc. during the course of this examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities set forth in this report, to the extent possible utilizing Company records and accounts.

In addition to the undersigned, Harland Dyer, MAAA, ASA, FCA, representing the Alabama Department of Insurance, participated in this examination of Knights of Peter Claver, Inc.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas W. Salo", written over a horizontal line.

Thomas W. Salo, Examiner II
Examiner-in-Charge
State of Alabama
Department of Insurance

May 25, 2007